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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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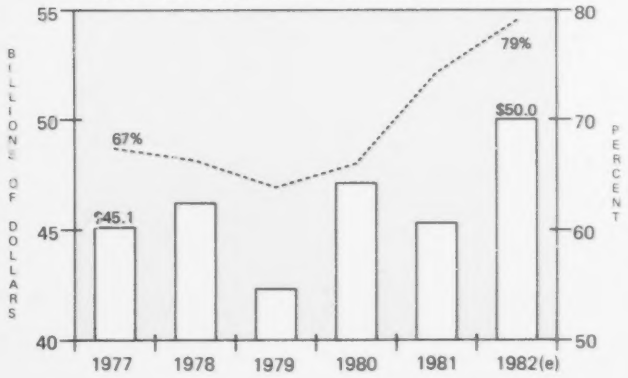
For State And Local Governments . . .

Despite the well-publicized, and well-founded concern of financial market participants over the vast size of Treasury borrowing requirements, one further negative element overhanging the bond markets is the prospective size of state and local government borrowings. These entities, in an attempt to cope with the challenges of recession, reduced Federal grants and escalating costs, will probably have little choice but to either increase taxes, scale back significantly the provision of both essential and nonessential services or step up sharply short- and long-term financings. In any event, the emerging dilemma seems to suggest record state and local borrowings this year—which, in the absence of a similar-sized rise in investor demand, could keep municipal bond rates high—if not push them up further.

Unfortunately, widespread joblessness and rising costs have already resulted in the virtual disappearance of the operating budget surplus of state and local governments (which excludes the activities of their pension funds) in the fourth quarter, only magnifying the dilemma. Whereas this surplus totaled more than $10 billion just four years ago, providing a significant cushion against the adverse effects of economic downturns, it has since

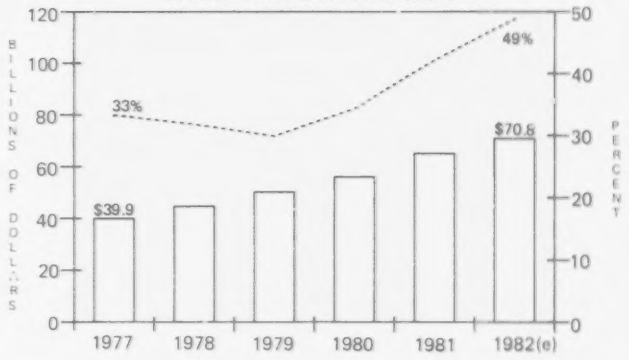
CHART I
NEW MUNICIPAL BOND ISSUANCE (BAR) VS.
BBI AS A % OF COMPOSITE AA UTILITY RATE (DOT)



narrowed sharply—to an estimated $400 million in the fourth quarter of 1981, and may well slip into deficit this quarter.

In response, local government borrowings have already begun to soar. New bond issues totaled almost $13 billion in the fourth quarter of 1981, 26 per cent higher than year-earlier levels; in 1982 they could reach as high as $50 billion—a record high.

CHART II
TOTAL DIVIDENDS PAID (BAR) VS.
DIVIDEND PAY-OUT RATIO (DOT)



The upturn in financing needs comes at an inopportune time. Most important, the supply-demand balance suggests falling bond prices and rising yields. Although new issue volume is soaring, such traditional institutional purchasers of municipal bonds as property insurance companies and commercial banks are expected to be relatively small net demanders of new offerings in 1982. Cash flow difficulties are expected to continue to plague many property insurance companies this year, limiting their ability to take down a significant amount of new municipal offerings, while commercial banks are also expected to be relatively unenthusiastic net purchasers of municipal bonds.

. . . The Financial Outlook Is Dim

This leaves much of the financing burden to be shouldered by households. But in order to attract individual investors at a time when bond market volatility in general and perceptions of credit risk in particular have diminished the attractiveness of bonds, yields have had to move higher. The Bond Buyer Index of 20 Municipals, for example, soared to 13.13 per cent during the week ending February 4, one of its highest levels ever. This trend,

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in turn, has resulted in a sharp narrowing of the yield differential between tax-exempts and taxables. The differential between the Bond Buyer Index (largely double- and single-A rated municipals) and composite double-A utility yields narrowed to one of its lowest points in a decade by late 1981; as shown in Chart I, tax-exempt yields now stand at almost 75 per cent of taxable yields and could approach 80 per cent in 1982.

Whether this convergence of rates will eventually set the stage for some price rebound in the tax-exempt area remains unclear. In the interim, however, swelling credit needs and lackluster investor demand for long-term bonds have forced many municipalities to shift their financings into the short-term note market. With investor interest greater and yields lower, borrowings in this segment of the municipal market in fourth-quarter 1981 rose almost 80 per cent above year-earlier levels—indicative of the hopes of many municipalities that the disarray in the longer-term markets is only temporary, and that long-term finance can eventually be secured.

And For Corporate America . . .

State and local governments are not the only entities experiencing significant difficulties in securing long-term finance at reasonable cost. The inability of U.S. corporations to generate strong earnings

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 1/27/82	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	135.246	+ .288	+ 9.519
Loans to Depository Inst.	2.417	+ 1.521	+ .678
Float	3.358	– 3.336	+ .123
Total Reserve Bank Credit	150.877	– 1.294	+10.685
Treasury Deposits with Federal Reserve Banks	6.147	+ 2.435	+ 2.649
Currency Outside Banks	123.699	– 1.497	+ 6.765
Member Bank Reserves:			
Required	42.703	– 1.579	+ 2.052
Excess (Deficiency)	– .070	– .466	– .470
Total Reserves Held	42.633	– 2.045	+ 1.582
Net Borrowed Reserves	2.445	+ 1.961	+ 1.189
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	95.533	+ .103	+ 2.506

Monetary Aggregates †			% Change Since Three Months Ago*	% Change Since Year Ago
M1		447.6	+ 14.3‡	+ 6.9‡
M2	(December '81)	1,841.2	+ 12.2	+ 10.3
M3	(December '81)	2,187.2	+ 10.0	+ 11.3
L	(September '81)	2,574.4	+ 11.4	+ 11.5

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 2/5/82	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	13.15%	13.20%	12.85%
* Federal Agencies	13.90	14.55	14.79
* Project Notes—Taxfree (46% Taxable Equivalent)	12.96	13.70	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	15.35	15.40	15.75

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	14.63%	Mar.	14.70%
15- 29 days	14.88	Apr.	14.60
30- 59 days	14.75	May	14.50
60- 89 days	13.50	Jun.	14.40
90-179 days	13.25	Jul.	14.20
180-239 days	13.25	Aug.	14.10
240-270 days	13.25		

‡Industrial Paper—Prime		†Federal Funds	
30- 89 days	14.75%	Effective Rate	15.25%
90-120 days	14.63		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'81	$ 2,985	$ 2,965	$ 2,731
Gross National Product (1972 Dollars)*	4th Q'81	$ 1,496	$ 1,516	$ 1,486
Percent Change, Annual Rate	4th Q'81	– 5.2	1.4	3.8
Change in Consumer Prices (all urban consumers)*	Dec '81	4.8%	6.0%	12.0%
Change in Producer Prices*	Dec '81	3.6%	6.0%	4.8%
Civilian Employment (Thousands of Persons)†	Jan '82n	99,581	99,613	97,696
Unemployment as % of Civilian Labor Force†	Jan '82n	8.5%	8.8%	7.4%
Personal Income	Dec '81	$ 2,492	$ 2,488	$ 2,277
Leading Indicators Composite Index (1967=100)†	Dec '81	129.4	128.6	136.4
Industrial Production Index (1967=100)†	Dec '81	143.3	146.4	150.4
Net Change in Consumer Installment Credit†	Nov '81	$ 0.34	$ 1.01	$ 0.84
U.S. Merchandise Trade Balance†	Dec '81n	–$ 0.70	–$ 3.40	–$ 2.19
Plant and Equipment Expenditures*	1st Q'82	$345.46(a)	$332.69(a)	$312.24
Private Housing Starts (Thousands of Units)*	Dec '81	978	863	1,535
New Construction Expenditures*	Dec '81n	$ 229.3	$ 231.6	$ 245.4
Total Business Inventories†	Nov '81	$ 515.2	$ 511.7	$ 474.9
Total Business Sales†	Nov '81	$ 344.6	$ 345.3	$ 339.0

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

growth in light of slumping productivity and escalating costs has ensured that internally-generated funds continue to fall far short of capital spending. And when you consider that the quality of after-tax earnings has exhibited little improvement, as corporations continue to post sizable gains in inventory profits and run inadequate depreciation allowances, a rather sizable financing gap emerges which must be bridged by external borrowings.

But with the bond markets in disarray, short-term credit has had to fill a good-sized proportion of corporate financing needs. Since mid-1978, for example, commercial and industrial loans outstanding at large weekly reporting banks have increased by almost $65 billion while commercial paper issuance by nonfinancial corporations, an alternative to bank loans for some, has risen by $37 billion. And, with short-term interest rates reaching historic highs during this period, it is hardly surprising that many key indicators of corporate financial health have deteriorated.

One measure of liquidity, the ratio of short-term to total liabilities, rose from 36 per cent in 1978 to 42 per cent in the third quarter of 1981 (the latest data available), a record high. The debt service burden also rose sharply during the period, with the percentage of gross internal funds required to service existing debt rising from approximately 26 per cent

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (1/20/82)	133,454	+ 432	+19,285
New York City (1/20/82)	32,670	– 95	+ 3,376
Commercial Paper (1/20/82)	166,029	+ 1,153	+36,286

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/20/82)	194,836	+ 190	+22,482
New York City (1/20/82)	55,468	+ 189	+ 4,386

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/20/82)	466,150	– 2,524	+36,739
New York City (1/20/82)	108,819	– 1,540	+ 7,459

Financial Markets

	Friday 2/5/82	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	14.38%	+ .98	– 1.72
180-Day Bills†	14.78	+ .98	– .72
Longest Bills†	14.73	+ .53	+ .18
Recent Issues:			
15s 1/31/84	14.97	+ .42	
14 1/8s 12/31/85	14.76	+ .36	
14 5/8s 2/15/92 (When Issued)	14.70	NA	
14s 11/15/11	14.59	+ .54	
Municipals:			
Bond Buyer–20 Bond Index* (2/4/82)	13.13%	– .02	+ 3.23
Blue List Total ($ Million)	$ 847	+ $ 45	+ $ 240
30-Day Visible Supply ($ Million)	$1,570	+ $185	– $ 748
Total	$2,417	+ $230	– $ 508
Corporates:			
Moody's Aa Composite (2/4/82)	15.80%	+ .01	+ 2.08
30-Day Visible Supply ($ Million)	$9,392	+ $475	+ $5,449
Stocks:			
Dow-Jones Averages:			
Industrials	851.03	– 20.07	– 101.27
Transportation	357.17	+ 1.03	– 51.47
Utilities	106.95	– .56	– 5.25
65 Stocks	335.03	– 4.20	– 37.98
Standard and Poor's 500 Stocks	117.26	– 3.14	– 13.34
N.Y.S.E. Composite Index	67.79	– 1.60	– 7.04
N.Y.S.E. Avg. Daily Vol. for Week (000's)	49,868	– 5,870	+ 4,484

* 46% Taxable equivalent 24.31%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 2/5/82	Week Ago
Overnight	15.38%	13.88%
1 month	15.50	14.13
3 month	15.63	14.50
6 month	15.75	15.00
1 year	15.75	15.13
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	14.99%	14.80%
Long Term (7 to 15 yrs.)	15.20	15.05

FOREIGN EXCHANGE SPOT RATES

New York Opening (2/5/82)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02507	39.89
Canada	.8296	1.2054
Denmark	.1309	7.6403
France	.1683	5.9425
Germany	.4278	2.3375
Italy	.0007995	1250.80
Japan	.004295	232.83
Mexico	.03728	26.825
Netherlands	.3902	2.5625
Switzerland	.5330	1.8763
U.K.	1.8670	.5356

in 1978 to 42 per cent in the third quarter of 1981.

. . . It's Not Much Better

Nor did this bleak picture, or corporate earnings performance, improve much in the fourth quarter. With the recession deepening, the profits slump worsened. Before-tax profits of nonfinancial corporations are estimated to have declined by more than 12 per cent compared with quarter-earlier levels, while after-tax profits are estimated to have skidded by about 11 per cent during the period.

But despite probable double-digit profit declines in late 1981, dividend payments continued to surge. Cash distributions rose to an almost $70 billion seasonally adjusted annual rate in the fourth quarter, and reached about $65 billion for the year as a whole. This total was $9 billion higher than cash payouts in 1980 and about $15 billion higher than in 1979—a year in which after-tax profits were about $20 billion greater than now. As a result, the dividend payout ratio, which relates dividends and after-tax corporate profits, exceeded 42 per cent in 1981, its highest level since 1971 (see Chart II on page 1).

If, however, corporate earnings in 1982 slump further and corporations continue to boost, or even maintain, existing dividend payments, the dividend payout ratio could reach as high as 49 per cent this year—placing another heavy strain on corporate balance sheets. Already, many companies have chosen to cut back dividend distributions in an attempt to boost retained earnings. This development, if it becomes widespread, would ensure that not only the bond markets, but also the equities markets will experience significant difficulties in launching sustained price advances in 1982. H

THE CORPORATE TRUSTEE ENDURANCE TEST.

DURABILITY:
When picking a corporate trustee for a bond issue—whether you're a corporation or municipality—pick carefully. Because you're going to have to live with that trustee a long time.

Manufacturers Hanover is one of the nation's largest and most experienced bond trustees. We have the expertise to anticipate problems before you even close the issue. By identifying trouble spots early, everything will run more smoothly. Year after year.

SUREFOOTEDNESS:
As corporate trustee, Manufacturers Hanover moves quickly in handling the day-to-day administrative tasks of overseeing a bond issue.

We consistently meet the NYSE and SEC requirements for the prompt transfer of certificates from seller to buyer. With TRANSIFAC,™ our electronic nerve center, each entry of data is "key verified"—entered twice by two different operators and then compared automatically by computer. It's the most accurate bondholder record-keeping system available.

ADAPTABILITY:
If a new or unusual change suddenly affects your company, Manufacturers Hanover reacts quickly in interpreting and analyzing indenture provisions. We know the alternate ways of handling many situations to help ensure the continued workability of the issue.

SENSE OF DIRECTION:
Our operations center is located in the heart of Wall Street, where most security trades take place—a location that facilitates the issuance and transfer of certificates for both you and your bondholders.

DETERMINATION:
No corporate trustee is more committed to service than Manufacturers Hanover. In addition to your own individual account officer, a backup officer—familiar with the requirements of your account—is ready to help you. Anytime.

If you want a corporate trustee who can meet every test, talk to Manufacturers Hanover. For more information on our whole range of indenture trusteeship services, call Joseph Unger, Vice President, at (212) 623-7542. Or write us at 40 Wall Street, New York, N.Y. 10015.

IF YOUR TRUSTEE CAN'T PASS IT, TALK TO MANUFACTURERS HANOVER.